



1932

## Economic Conditions Governmental Finance United States Securities

New York, May, 1932.

### General Business Conditions

**T**HE action of the Federal Reserve authorities in determining to buy Government securities on a largely increased scale is a new and important development in the business situation. The Reserve Banks about the end of February began a program of purchases which averaged \$25,000,000 weekly during the five weeks ended April 6. On April 13 Governor George L. Harrison of the New York Bank made a public statement that "the program has again been speeded up in rate and volume." The report of condition of the Reserve Banks on April 13 revealed an increase of holdings of Governments during the week of \$100,000,000, and in the succeeding two weeks an increase of \$206,000,000 occurred.

This action of the Reserve authorities, taken for the purpose of creating easier money conditions, and thereby enabling the member banks first to free themselves of indebtedness to the Reserve Banks and then to offer funds more freely to the public or buy securities themselves, is probably the most important stroke of central bank policy ever made. Open market operations have never been undertaken before on the scale cited, but some way needs to be found to increase the amount of credit available, and evidently bolder and more powerful methods are called for than ever have been necessary in the past.

#### Principles of Open Market Operations

Open market operations for the purpose of influencing the money market are comparatively new in central bank practice. Central banking is an evolution in Europe from almost unregulated private banking, with numerous banks of issue, and the first step was by concentrating currency issues in each country in one central institution closely related to the Government. Its position as the source of currency issues naturally placed the central bank at the head of the country's banking system, other banks using it as a depository, looking to it for rediscounts as occasion might require and following its lead in financial policies of public importance. The central banks devel-

oped by experience the practice of using the discount rate to control the volume of credit and the movements of gold into and out of the country. Reserve Bank credit is "money" in the market, and an advance of the discount rate tends to make "money" dearer throughout the country while a lowering of the rate has the opposite effect.

The influence of the discount rate has been supplemented to some extent in recent years by open market operations, to wit, purchase or sale of securities by a central bank. A purchase by the bank giving a check on itself in payment puts credit into the money market and tends to make "money" easier, while, per contra, a sale of securities by the bank withdraws funds from the market and tends to make "money" dearer. Credit for discovery of the efficacy of open market operations naturally belongs to the Bank of England, which long has had the problem of dealing with larger gold movements than any other institution and also has had resort to the most effectively organized money market in the world. It does not appear that other foreign central banks have used the practice to any great extent.

The Federal Reserve authorities have resorted to open market operations rather freely, buying and selling United States Government securities. The principle followed is that purchases are made when business is depressed, and sales when business is over-expanded, the aim being to promote stability in credit, prices, and trade. A statement by the New York Federal Reserve Bank to the Glass sub-committee of the Senate Banking and Currency Committee early last year gives the conditions under which the operations have been undertaken as follows:

Generally speaking, purchases of Government securities since 1922 have been made at times of business depression or recession in the United States accompanied by unemployment, declining foreign trade, weak commodity prices, and reduced speculative activity. Broadly speaking, also, sales of securities have taken place at times of large industrial activity, full employment, firm commodity prices, and tendencies toward excessive speculation. \* \* \* Purchases and sales of government securities since 1922 have

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been such as might reasonably be expected to exercise some influence toward business stability by aiding recovery at times of depression and retarding excesses at times of prosperity.

Following these principles, purchases in substantial volume were made in 1922, 1924 and 1927, periods of depression or threatened depression, and sales were made in intervening times to reduce the holdings and with a view to dampening speculative activity. At the end of 1929 and during 1930 the holdings were increased, and further purchases were made during 1931, though their effects were lost in the panic. When the Glass-Steagall bill became a law on February 27, 1932, the holdings amounted to \$741,000,000. The banking situation having improved, but contraction of credit continuing, the time seemed appropriate for resumption of purchases, and the Glass-Steagall Act, by making such holdings available as the basis of currency issues, favored larger operations of this kind. For these reasons the purchases since made have aggregated \$450,000,000.

#### Reserve Banks Take the Initiative

The special usefulness of open market operations exists in the fact that the Reserve Banks take the initiative in making funds more plentiful. Ordinarily the initiative is with private borrowers, who apply to the banks where they do business. If these banks are without surplus reserves it is their custom to borrow temporarily of the Reserve Banks to replenish them. This system works well enough in normal times and affords opportunity for the Reserve authorities to use the discount rate to restrain excessive borrowing. It does not work so well when liquidation of bank credit is under way, with deposits and reserves falling by reason of the public determination to get out of debt, and by reason of the contraction caused by gold and currency withdrawals. Bank deposits for the most part are made by bank loans and investments, and decline as the volume of loans and investments is reduced. This credit can be called out again by a resumption of borrowing by the public, but with such extreme pessimism as has been manifested in the last year the public is disinclined to take the initiative and the banks are disinclined to borrow from the Reserve Banks to make loans, the more so as they have been compelled to borrow to meet cash withdrawals. Hence has resulted a shrinkage of about \$500,000,000 in reserve deposits, at the low point of this year compared with one year ago, and of nearly four billions in loans and investments, of the reporting member banks only, in the same period.

This is credit lost to the current supply and the loss is an obstacle to business recovery. Since the public does not take the initiative to correct the situation, it is necessary for the

credit-making authority to do so and by its own action increase the amount of credit available in the market. This can be done by the purchase of Government bonds, issuing new credit for the purpose. The checks given for the bonds will be deposited in banks and thence pass back to the Reserve Banks, either in payment for past rediscounts or for credit in the reserve accounts of the member banks, where the credit will serve as the reserve base for a possible expansion of member bank loans or investments in at least ten times the volume.

#### Effects of Reducing Rediscounts

The indebtedness of the member banks to the Reserve Banks at present is an abnormal one, an effect of credit strain caused by the demands for currency and gold beginning last September which forced rediscounting in the largest amount since the Fall of 1929. Of course, this borrowing did not add to the supply of credit, being more than offset by the currency and gold withdrawals. Since the beginning of this year, with currency returning to the banks, rediscounts have been declining. The new credit will further assist the member banks in paying off their debt, first in the larger centers and thence working outward, and as the volume of rediscounts is reduced the number of banks wholly out of debt to the Reserve Banks will increase and the strain on others will be lessened. As this is accomplished the accumulation of Reserve funds will naturally result in a more liberal attitude toward loan applications by the banks or possibly in bond investments for themselves, either of which will put the credit or "money" into circulation.

A manifestation of strength in the bond market will be helpful not only to Government but corporate financing, thus providing the means for expenditures which will increase employment. In short, by placing funds in the money market, where business goes to finance its needs, it supplies funds in the manner most helpful to sound business revival, supplies it by an orderly process, assuring wide distribution, and avoids the dangers that attach to large issues of paper money. It is a careful and calculated method, under experienced control, of overcoming the excessive deflation of credit and of encouraging business confidence and enterprise. Of course, an increased volume of currency will naturally result as needed by increased activity in business.

A further word may be said upon the attitude of the member banks, since it is the subject of very free comment. There are inquiries as to whether, or to what extent, the banks will put the new Reserve credit to use, and some of the comment implies that there is no alternative between a policy of allowing

the credit to stand idle as excess reserve, which would nullify the Reserve Banks' efforts, and one of making loans and investments at excessive risk, which would be unsound banking.

However, there is no such sharp line. Between the alternatives of excessive risk and excess reserves there is a border area of indeterminate width in which the policy of credit expansion may be expected to take effect. As stated, the market for Government and other very high grade securities of unquestioned safety provides one channel for release of the credit. Moreover, the policy is calculated to revive enterprise and stimulate a demand for credit by good borrowers. Relief of the situation in communities whose credit facilities have been impaired by bank failures or by the effects of fear provides another channel. The effect of the operations of the Reconstruction Finance Corporation is to restore the liquidity of banks which have been compelled to deny credits, and which indeed have become collectors instead of lenders. The effect of the Reserve policy is to put new funds into the market which will become available to these banks, the two policies working together.

#### World Cooperation Desirable

Undoubtedly this policy would have been inaugurated earlier but for manifestations of European misunderstanding of the measures being adopted in this country for relieving the credit situation, and the gold withdrawals from this country in consequence. Europe on account of past experiences is very sensitive to rumors about inflation or possible departure from the gold standard, and while this country has gold enough to meet any probable demand it is desirable that misunderstanding should not be promoted. Financial circles in Europe now generally approve of the measures that at first were questioned, and of this Federal Reserve policy, holding them soundly conceived and helpful to the world situation.

The inauguration of this policy on the scale now contemplated may result in the development of world cooperation by central banks for the more effective control of credit and prices. Obviously the banking system of a single country cannot exercise the control over world prices that might be exercised by the banking systems of all countries or even the banking systems of a group including the more important countries, acting together. The prices in different markets of commodities entering into international trade are interlocked, and while they react upon each other they must move promptly together, or the lagging ones will be a drag upon the others. Moreover, there is danger that a country leading an advance may lose trade by it. But all

countries have a common interest in the stability both of credit and prices.

Able economists have maintained for years that the central banks of the world possessed the requisite organization and power, acting in cooperation, to stabilize the state of credit and the general price level to such an extent as to prevent the wide fluctuations which result in panic and disorder. Practical bankers have admitted the theoretical soundness of the principles involved, but feared popular opposition to anything that looked like international control of money and credit. Such cooperation, of course, would not attempt to control particular prices, and probably would not attempt to do more with general price movements than prevent the wide swings that result from excessive inflation and deflation of credit.

It is possible that the action now being attempted may enlist similar action in other countries and demonstrate the value of such continuous cooperation. The markets of the United States, by reason of this country's position as a source of supply of many commodities, exercise an important influence upon all world markets, but the effort to revive business and raise the price level should have support everywhere. The Reserve System is giving the lead.

#### Reconstruction Finance Corporation's Loans

Aid extended by the Reconstruction Finance Corporation and the dissipation of fears concerning banks have had a marked effect in reducing the number of bank failures, which totaled 342 in January, 122 in February, only 45 in March, and 41 in April up to the 21st, in the American Banker's compilation. At a hearing in Washington, General Dawes, President of the Reconstruction Finance Corporation, gave details of its operations through April 19, stating that loans had been made to 1,520 banks totaling \$243,248,769, of which \$10,047,158 had been repaid, leaving \$233,201,611 outstanding. A great majority of the loans have been in small amounts, and General Dawes further stated that 88.9 per cent of the banks receiving them were in towns of less than 25,000 population, while over two-thirds of the money loaned went to towns and cities of less than 100,000 population.

The foregoing is evidence that the relief afforded by the Corporation is for the widespread benefit of the country. It is extended through the credit-granting institutions because the savings of the country have been entrusted to these institutions, and because business revival and increasing employment are most directly promoted by conserving these savings and sustaining the ability of the institutions to grant credit. Differentiation of relief as "at the top" or "at the bottom," is a

meaningless one, the flow of credit being necessary to the welfare of all.

Along with the decrease in failures, the return of currency is evidence of improvement in the banking situation. Effective proof that the currency coming in to the banks is out of hoards appears in the report of circulation on March 31 by denominations. During the month the paper currency outstanding in denominations of \$10 and less, constituting money of ordinary use, decreased \$35,000,000, while the higher denominations, representing hoardable currency, decreased \$74,000,000. Gold coin decreased \$3,000,000, and gold certificates, included in the foregoing paper currency figures, decreased \$41,000,000.

In April a further net decrease in circulation has occurred, though in smaller volume than in March.

#### Trade and Industrial Conditions

The improvement in the banking situation thus far has had little reflection in general business. Poor earnings and trade reports have combined to make April a month of disappointment, with effects evident in the weakness of the stock and commodity markets.

To a great extent hopes of early industrial improvement are centered on the automobile industry. It is recognized that the cars offered this year represent values much superior to any ever offered before, and the industry is making aggressive sales efforts accompanied by timely price reductions. The news for April is very favorable by comparison with earlier months. The General Motors Corporation states that during the first ten days of April, covering the period of special exhibitions of its products, its sales totaled 57,000 vehicles, which is greater than during the full month of March. The Chrysler Corporation makes a similar report concerning its new model Plymouth, and the Ford backlog of orders is a large one, being estimated in the trade press at 300,000 cars. Production thus far has increased but slowly. April is usually the peak month in the industry, but evidently this year the peak will come later.

Steel production dropped off slowly up to the last week of the month, when a turn occurred based upon automobile orders.

The automobile situation is evidence that a belated "Spring rise" may be still ahead in some industries. A steady falling off in general business activity from the March-April peak to the July low point is usual, and the prospect that among the major industries there will be exceptions to this trend, giving support to the seasonally adjusted indexes which are being so anxiously watched for evidence of a turn in the long road of recession, is the most clearly favorable feature in evidence.

Building contracts awarded up to the 22nd of the month gained over March, but the

figures are not very impressive, showing a decrease of 64 per cent from one year ago. Retail trade has improved somewhat with more seasonable weather, but the effects of its dullness during the first quarter have become apparent in slackness in the industries making consumers' goods. However, car loadings of merchandise and miscellaneous freight provide some encouragement, showing moderate gains since the first week of the month.

The forthcoming two months will be very important ones in the history of the depression, involving legislative and diplomatic decisions of great consequence. The fiscal legislation of the Government has been the subject of controversy, very harassing to business sentiment, which recognizes that the probable consequence of an unbalanced budget would be a flight of capital from the country, causing further deflation. However, the developments of the month have been reassuring and justify a belief that Congress will provide governmental economies and tax increases to balance the budget as closely as may be estimated at this time. There is argument over the taxes and economies, but agreement on the greater issue. The inflationary bonus proposal is another cause of disturbance which also is likely to be removed soon, by defeat or veto.

The Lausanne Conference upon reparations and inter-government debts is scheduled to meet June 16. The affairs of the Danubian States are critical and a concord for their economic rehabilitation is needed. It cannot be doubted that the supreme need of the time is the cooperation of all countries in a settlement of these questions in a manner that will induce once more a normal flow of capital, cause it to seek the places where it is most needed and which it now most shuns, and will promote instead of strangling world trade.

#### Money and Banking

The action of the Federal Reserve Banks already described in this Letter, supplying new funds to the market in greatly enlarged volume, has been the chief influence in the money markets during the past month, and has had an immediate effect upon rates on short term loans and investments for which demand is created by this piling up of funds. The following table gives rates at the beginning and end of the month, call loans only showing no change although concessions from the established rate have been made in the "outside" market:

	April 1	April 28
Call Money .....	2½	2½
Time Loans 60-90 Days.....	2¾-3	1¾-2
"      " 4, 5, 6 Months.....	2¾-3	2 - 2¾
Commercial Paper, Best Names.....	3¾-4	3¾-3½
"      " Others.....	4	3¾
Acceptances, 90-days, Asked.....	2½	¾

The series of cuts in acceptance rates has been the sharpest on record; the new rate

equals that established last May when the Reserve Banks conducted a similar easy money campaign, and is the lowest in the history of the American bill market. The rate cuts have been made by dealers in hope of obtaining bills for their portfolios, but the supply is moderate and under the conditions banks tend to hold their bills themselves.

Further evidence of the prompt effect of the Reserve Bank policy is found in the yield rate on short-term United States securities, which has declined very drastically. The seven months'  $3\frac{1}{8}$  per cent notes sold on March 15 are currently priced to yield 0.57.

#### Change in Reserve Banks' Position

Since February 24 the banks have gained funds largely through \$450,000,000 of bond purchases by Reserve Banks, and through the return of \$194,000,000 of currency from circulation. The first use to which these funds have been put is in retiring member bank borrowings from the Reserve Banks, which have been reduced \$303,000,000. A further offset is a reduction of \$87,000,000 in the Reserve Banks' holdings of bills purchased. Of the remainder of the new credit \$236,000,000 has gone to increase the reserve deposits of the member banks, supplying the base for expansion of their own credit.

The reduction in rediscounts has been spread well over the country, tending to ease the credit strain where it has been tightest. Indebtedness of country banks to their correspondents has been paid off, and their balances in the large centers have mounted. As the Reserve Banks' bond purchases are necessarily made in the chief security markets, the first effect is to ease rates in them. However, Government disbursements, including Reconstruction Finance Corporation loans, out of funds raised in the larger centers tend to distribute the funds over the country. Moreover, as the yield of prime short term investments declines the inducement for country banks to employ their balances at home even at somewhat greater risk is increased, thus further tending to spread the easing effects of the policy.

As the ultimate aim of Reserve Bank policy is to bring about expansion of member bank loans and investments, that item in the immediate future will be the most significant in the bank statements. In the week ended April 20 the total gained \$61,000,000, which was the first increase in any week since the end of September, except at the quarterly tax dates when subscription to government security offerings was made. The increase occurred in the investment account of the banks, and principally in New York, and is therefore evidently a direct result of the Reserve Bank policy, and a hopeful beginning.

#### The Gold Movement

The inward movement of gold which prevailed during March was reversed after the first week of April, when concern apparently was aroused in Europe by discussion of the inflationary proposal to issue currency to cash the veterans' compensation certificates. Gold was shipped to France in the amount of \$24,000,000. However, the alarm quickly subsided and French franc exchange reacted below the gold point. In the latter part of the month Holland began the repatriation of her gold held here, which had been previously earmarked; the transaction is therefore without effect on this market. Up to the 28th of the month exports had totalled \$45,000,000 and imports \$12,000,000, while \$7,000,000 had been released from earmark, resulting in a net loss of \$26,500,000. This does not erase the gain in March, which was \$31,000,000.

An important event of the month was the reduction in the Bank of England rate on the 21st to 3 per cent. This followed the London bill rate down, and is evidence of the determination of the British authorities first to promote easy money for home use, and second to discourage any temporary movement of short term balances to London, which would tend to raise sterling above its natural level while moving in, and might be moved out again at some later time when the withdrawal might be embarrassing.

#### The Bond Market

The increased pressure put behind their easy money campaign by the Reserve Banks in the middle of April materially strengthened the bond market. The new funds made available to the banks have been in part invested in high-grade bonds, including state and municipals and the highest rated corporate bonds as well as U. S. Governments, and the lower-rated issues and speculative grades were affected as well by the hope of a turn in the situation. In the early part of the month the average price level of corporate bonds declined severely under the effects of poor earnings reports and general discouragement, and dropped to nearly the December lows, but the subsequent rally was a sharp one.

The rise in Government bonds during the month has been rapid, the long term issues gaining 3 to 5 points. The statement is frequently met that this rise is directly due to Reserve Bank buying of these bonds, but this is a mistaken view, since during the three weeks ended April 27 the Reserve Bank purchases of \$306,000,000 included only \$28,000,000 of bonds, the remaining \$278,000,000 being short term obligations. What has advanced the market for the long term issues is the buying by banks put in funds by the Reserve

policy, and by other investors whose confidence in the market has been strengthened by it.

Aside from the highest class issues, in which the improvement in buying has been principally concentrated, there has been some pickup in obligations rated slightly lower but strongly protected by the asset value of the corporation behind them. Bonds which are poorly secured, or which contain large speculative risks due to lack of adequate earnings, are relatively weaker, and a broadening in demand for these types of issues, even at the abnormally high yields afforded by prevailing quotations, doubtless must await stronger evidence of betterment in general business. The subnormal traffic reports have discouraged buying of the railroad bonds, though the Reconstruction Finance Corporation loans, which up to April 19 totaled \$77,515,000 to 20 roads, continue to give assurance of aid to otherwise sound roads which have capital obligations maturing in this difficult period.

Public offerings of new securities during the month totaled approximately \$205,000,000 and were confined almost entirely to municipal and utility issues, the most important of which were \$30,000,000 in one and three-year notes of the Edison Electric Illuminating Co. of Boston, and \$24,000,000 in 4½ and 4¾ per cent serial bonds of the Boston Metropolitan District.

On April 26 the Comptroller of the State of New York allotted an issue of \$75,000,000 in one-year 2¾ per cent notes at par to a group of seventy-five New York State banks and banking houses. Total subscriptions to the loan amounted to approximately \$200,000,000 and the bonds were immediately bid to a premium in the open market.

#### U. S. Treasury Finances

On April 24 the United States Treasury announced the offering of two issues of \$225,000,000 each to be dated May 2, one of certificates to run one year and bear 2 per cent interest and the other of notes running two years at 3 per cent. The response was a very large one, the two-year issue being over-subscribed more than eleven times, and the one-year certificates nearly eight times. The subscriptions were spread well over the country, and give evidence of the volume of funds that is available for prime short term investments, while awaiting a revival of confidence and business activity that will turn it into the long term market at higher yields.

A revised official estimate of the requirements of the Treasury from May 3 to the end of the fiscal year, June 30, indicates that new issues of approximately \$1,059,000,000 will be necessary to refund fixed maturities in bills

and certificates of \$794,000,000, and to finance an operating deficit of \$265,000,000, and that the gross public debt outstanding on June 30 will be \$19,316,000,000. This would represent an increase of \$2,514,000,000 for the year.

Congress has repeatedly expressed its determination to balance the budget and arrest further borrowing before the end of the 1933 fiscal year. In no other way can a sound condition of government finances be assured. To achieve this object, however, will require not only the rounding out of the program for raising revenue but the adoption of drastic economies and the rejection of new projects for spending public moneys.

#### First Quarter Profits

Combined net profits for the first quarter, of a group of one hundred and seventy industrial corporations whose reports were published last month, aggregated \$21,000,000, compared with \$9,000,000 in the preceding quarter and \$107,000,000 in the first quarter of 1931; this after deducting all charges but before dividends. Relatively the best showing was made by the chemical and the baking and other food products companies.

The gain over the results of the preceding quarter was due to the fact that the final quarter is always burdened with certain adjustments incident to closing the accounts, and that at the end of 1931 numerous special charges were made for the purpose of writing down to market the valuations of inventories, receivables, investment securities, foreign exchange and fixed assets.

The principal forces against which the manufacturing industries have been operating since 1929 are, first, the falling off in purchasing power of the public and the consequent curtailment of production to a rate far below their potential capacity and even below that at which profitable operations are possible, and, secondly, the decline in commodity prices, which restricts buying, intensifies competition, causes inventory losses and takes a considerably larger quantity of goods sold to produce each dollar of profits.

A condensed summary of the available reports classified according to major industries is given in the table on the following page. Deficits were reported by about 43 per cent of the companies and aggregated \$49,000,000 this year, as compared with 28 per cent aggregating \$27,000,000 last year, all of which have been deducted in arriving at the totals.

#### Railroad Earnings

Despite the continued downward trend in volume of railroad traffic, a slight improvement in net earnings has been shown since the beginning of the year as a result of the

## FIRST QUARTER INDUSTRIAL CORPORATION PROFITS

Net Profits Are Shown After Depreciation, Interest, Taxes, and Other Charges and Reserves, but Before Dividends.

Net Worth Includes Book Value of Outstanding Preferred and Common Stock and Surplus Account at Beginning of Each Year.

(In Thousands of Dollars)

No.	Industry	Net Profits		Per Cent Change	Net Worth		Per Cent Change	Annual Rate of Return	
		First Quarter 1931	First Quarter 1932		January 1 1931	January 1 1932		Per Cent 1931	Per Cent 1932
1	Automobile—Gen. Motors .....	\$ 28,999	\$ 9,693	-66.6	\$ 966,802	\$ 923,803	-4.4	12.0	4.2
12	Automobile—Other .....	106	D-4,266	.....	363,678	324,196	-10.9	0.1	.....
14	Auto Accessories .....	4,626	369	-92.0	204,913	186,066	-9.2	9.0	0.1
6	Bakery .....	8,047	6,759	-16.0	289,079	284,290	-1.7	11.1	9.6
15	Chemicals and Drugs .....	20,700	15,238	-26.4	790,314	775,794	-1.8	10.5	7.9
5	Coal Mining .....	845	D-240	.....	95,305	92,560	-2.9	3.5	.....
5	Electrical Equipment .....	8,304	1,932	-76.7	724,637	696,065	-3.9	4.6	1.1
13	Food Products—Misc. ....	20,652	15,456	-25.2	620,941	595,827	-4.0	13.3	10.4
1	Iron and Steel—U. S. Steel.....	6,765	D-13,219	.....	2,059,089	2,003,693	-2.7	0.3	.....
15	Iron and Steel—Other .....	722	D-14,049	.....	1,532,474	1,453,688	-5.1	0.2	.....
12	Machinery .....	3,347	D-210	.....	228,199	206,476	-9.5	5.9	.....
8	Mining, Non-ferrous .....	1,667	253	-84.8	128,471	126,995	-1.1	5.2	0.8
9	Office Equipment .....	2,224	1,604	-27.9	115,799	114,505	-1.1	7.7	5.6
12	Petroleum .....	D-12,062	D-4,222	.....	908,811	836,161	-8.0	.....	.....
7	Textiles and Apparel .....	D-28	D-57	.....	87,662	82,315	-6.1	.....	.....
26	Miscellaneous—Manufacturing ...	9,071	4,647	-48.8	437,953	391,530	-10.6	8.3	4.7
15	Miscellaneous—Services .....	3,639	1,878	-48.4	237,195	225,246	-5.0	6.1	3.3
170	Total .....	\$107,624	\$21,566	-80.0	\$9,791,332	\$9,319,210	-4.8	4.4	0.9

D—Deficit.

drastic operating economies which the railroads have been forced to adopt, the ten per cent wage reduction which went into effect on February 1, and the emergency increase granted in rates on certain classes of freight. It now appears that the revenue to be derived from the rate increases this year may be no more than half the \$125,000,000 originally estimated. The report of the Class I railroads for January, 1932, showed net railway operating income of only \$11,713,613, which was the lowest for any month since 1920, and represented an annual rate of return on the property investment of only 0.71 of one per cent. Eighty of the 169 companies operated at a loss. There was a moderate recovery in February, when the net rose to \$22,042,614, and represented an annual return of 1.26 per cent. The total for March, partly estimated on the basis of individual reports published to date, will be in the neighborhood of \$32,700,000 and would represent a return of 1.53 per cent. Even this figure, however, is well below the cost of capital in the form of bonds, and the permanent health of the industry depends upon a recovery in volume of traffic, better regulation of competing agencies and permission to build up its surplus and reserves in good years.

### Low Commodity Prices

In depressions in the past the way out has often been provided by a rise in the prices of staple and especially of agricultural commodities. A proposition upon which everyone will agree is that a rise in the prices of basic commodities is needed if the depression is not to

drag out to unendurable length, and that credit policies calculated as effectively as may be to raise the price level are therefore desirable. Attention has been given in the opening pages of this Letter to such a policy initiated by the Federal Reserve Banks.

It is unnecessary to expand upon the fact that the decline in commodity prices has visited distress upon every country in the world and nearly all the people. It might be argued that creditors and those with fixed incomes are an exception, but there are few persons wholly in that class, since creditors are generally property owners also, and there is no kind of property and few incomes not affected by the deflation. There will be agreement that the fall of prices has been a principal force in the vicious circle of deflation and is therefore a cause as well as a result of business recession; it has discouraged enterprise, caused postponement of forward operations, and backed up supplies in producers' hands. The world stands to gain by reversal of this process and by central banking policies aimed at that goal.

### The Breakdown of Price Relationships

The decline in the price level has not been as great in percentage as it was in 1920-21, but it has now lasted twelve months longer than did that decline, and has been incomparably more disturbing. The drop in 1920-21 was a rapid one from a temporary peak generally recognized as such, and which had not been maintained long enough to allow a state of balance between different prices to be worked out. The present decline, however, started from a plateau upon which prices had

rested during the eight years 1922-29 inclusive, upon which a fair equilibrium had been worked out, a body of debt created, and which became accepted in the public mind as permanent.

The breakdown of these former relationships has been of unexampled severity. It is stated by Frederick C. Mills of the National Bureau of Economic Research, a leading authority upon price movements, that "The inequalities which have developed among the prices of the different classes of commodities during this period exceed any of which we have record during previous periods of price decline." The exchange of one product for another or for services, which makes up trade, has been disrupted by these inequalities in a degree not heretofore known, and the decline in trade forces price declines.

Producers of raw materials have suffered most from the disparities. An illustration is the index of farm prices for March, which stood at only 45 per cent of the 1926 average, whereas the latest calculation of the prices paid by farmers for commodities bought is 77 per cent of 1926, the effect being that the farmer's ratio of prices received to prices paid is only 58 per cent of that year, while as compared with the pre-war average it is only 51 per cent. All producers of raw materials have lost purchasing power over finished goods and disparities among the raw materials cause some producers to lose more heavily than others.

The modern economic system is a wonderfully flexible one when not arbitrarily inter-

fered with, and has always had to adapt itself to changing price relationships, but to none of such severity, and there is reason to believe that no such adaptation can be made. The conclusion must be that restoration of equilibrium will come about through reduction in the prices of manufactured goods, services, etc., that are high, or recovery in the raw materials that are low; and since they are not mutually exclusive, undoubtedly in both ways. But it is of great importance which way is to predominate, since the first will require prolonged and drastic liquidation in many channels, while under the second this process will be less severe and recovery therefore easier. The second is the way out that has developed in previous depressions, and the raw materials are most readily affected by the credit policies referred to. It may be said that the beginnings of recovery do not wait wholly upon regaining equilibrium; part of the process of recovery is in restoring the balance between various prices.

#### The Price Decline

The accompanying table is an informing one, showing not only the inequalities in the declines of the chief crude commodities as compared with the 1925-29 plateau and with pre-war, but also the number which have sold at either the lowest price on record or lower than since the '90s when the general price level made bottom in the history of the country. The list of commodities now or in recent months at an all time low is a lengthy one, including wheat, copper, zinc, silver, silk, rubber, sugar, hides, cocoa, and petroleum.

Record of Wholesale Prices of Principal Raw Commodities (in Cents)

Commodity	1913 Average	Average of 1925-29	Last Week in April 1932	Decline From 1925-29 Average in Per Cent	Pre-War Low	Post-War Low		
Pig Iron, Iron Age composite, dollars per ton	15.42	19.84	14.35	-28	9.98	1897	14.35	1932
Copper, elect, N. Y., lb.....	15.27	14.81	5.75	-61	9.00	1894	5.75	1932
Lead, N. Y., lb.....	4.37	7.46	3.00	-60	2.68	1896	3.00	1932
Zinc, N. Y., lb.....	5.61	7.11	2.97	-59	3.10	1895	2.97	1932
Tin, straits, N. Y., lb.....	44.32	56.64	20.00	-65	12.62	1896	18.62	1932
Silver, bar, N. Y., ounce.....	61.20	59.74	28.00	-53	47.33	1902	26.00	1931
Petroleum, crude, bbl.**.....	245.00	146.00	86.00	-41	51.38	1892	25.00	1931
Cotton, middling, N. Y., lb.....	12.77	19.54	6.10	-69	5.31	1898	5.50	1931
Silk, crack xx, N. Y., dollars per lb.....	3.72	5.59	1.38	-75	2.90	1915	1.38	1932
Jute, mixed, N. Y., lb.....	6.70	8.24	3.15	-62	1.88	1895	3.15	1932
Rubber, smoked ribs, N. Y., lb.....	82.00	40.60	3.00	-93	40.00	1914	2.95	1932
Coffee, Rio 7, N. Y., lb.....	11.13	17.10	7.75	-55	5.08	1903	5.25	1931
Sugar, raw, less duty, N. Y., lb.....	2.15	2.51	.65	-74	1.56	1902	.60	1932
Cocoa, Accra, N. Y., lb.....	18.94	12.11	4.42	-44	10.00	1910	3.87	1932
Wheat, No. 2 red, Chicago, Bu.....	98.60	150.68	55.75	-63	48.75*	1895	44.62*	1931
Corn, No. 3, yellow, Chicago, Bu.....	61.60	89.66	31.75	-65	19.50*	1896	29.50*	1932
Oats, No. 2 white, Chicago, Bu.....	37.60	48.70	22.75	-53	14.75*	1896	20.50*	1931
Butter, creamery extra, Chicago, lb.....	31.00	44.54	20.00	-55	13.50	1890	19.00	1932
Eggs, fresh, Chicago, doz.....	22.60	33.64	11.50	-66	10.00†	1898	11.50†	1932
Beef Steers, good, Chicago, lb.....	8.58	12.18	7.20	-41	3.00	1890	7.13†	1932
Hogs, heavy, Chicago, lb.....	8.45	11.12	3.55	-68	2.50	1896	3.55†	1932
Wool, Territory, fine and fine medium, lb.....	56.20	115.94	47.00	-59	29.03	1896	47.00†	1932
Hides, heavy native steers, Chicago, lb.....	18.40	18.08	4.00	-78	5.12	1894	4.00	1932
Average decline from 1925-29.....				-61				

\* Contract prices in Chicago

\*\* Pre-war prices: Pennsylvania crude; post-war prices: Mid-continent. 33-33.9

† Weekly average.

The average decline in the 23 commodities included in the table has been 61 per cent. The decline in the Bureau of Labor index of 784 commodities, including, of course, a wide variety of finished goods, has been only 33 per cent. This is the most widely published index in this country, but the total for all commodities is far from giving a true picture of the raw materials situation. Bradstreet's index, which is more largely crude commodities, is down 45 per cent, and the lowest since 1899.

There is much discussion as to the part monetary factors have played in the price decline, and money factors alone fall far short of explaining it, in view of the increase of production of many commodities during the boom to figures far in excess of any consumption ever known, and the subsequent disruption of trade. However, there will be little dispute that in the later stages the severe deflation of credit has been a factor depressing the price level. The hoarding of money is evidence of a higher value put upon money and a lower one upon commodities, each in terms of the other, and the slow turnover of credit is equivalent to an even greater reduction in the supply than has occurred.

In a number of commodities there are gleams of encouragement in the price outlook. There are but a few, and those of natural growth, in which the output has not been drastically curtailed and in some cases the visible supply is well below the peak. Stocks generally are large in relation to consumption, but not for normal needs. As a rule the real weakness in each situation has passed from the supply to the demand side of the price equation, and of course it is the latter which a larger volume and more rapid turnover of credit is calculated to support and increase.

#### The Wheat Situation

The poor condition of the United States winter wheat crop is of outstanding importance in the wheat situation. The acreage sown was reduced 10.4 per cent, and the weather has been unfavorable. The Government estimate of the yield on April 1 was only 458,000,000 bushels compared with last year's production of 787,000,000, and later private estimates suggest further reduction due to heavy acreage abandonment, drought and soil blowing in the Great Plains of the Southwest. If the crop turns out as short as this the wheat position in this country will be greatly altered. A larger spring wheat acreage is being planted but with an average yield the total wheat crop will not much more than equal domestic requirements alone. For the first time since 1926 there is promise of reducing the surplus substantially.

Russian conditions, of course, are of great importance, and there is evidence that Russia

will be less of a factor in the wheat markets than has been feared. Famine in the areas where the crop was short last year has made it difficult to collect seed for spring planting, and the government in February stated that preparations for ploughing and sowing had been "criminally neglected." At the same time it declared March a "shock month" in which to enforce crop preparations, repair machinery and feed up livestock. However, the reports are that only half of the seed quota set had been collected by the end of the month, and the condition of machinery and stock is "most unsatisfactory." The Russian land is suited to machine farming, but there is little evidence that the people are suited to it.

Shipments of wheat from the principal exporting countries to date have been ahead of last year and the exportable supply remaining on April 1 was smaller than last year. The world visible is dropping more rapidly than last year. European countries have liberalized their milling and import regulations to admit larger supplies of foreign wheat, and need the wheat of North America. The depressing influence of the unsold stocks is a hampering factor, but the wheat prospect is clearly a better one.

#### Cotton

Cotton is one of the few commodities of which consumption is running ahead of last year. According to the New York Cotton Exchange Service the world used 7,201,000 bales of American cotton in the seven months ended with February, compared with 6,275,000 a year ago, the greatest gain having been in the Orient where the relative cheapness compared with East Indian is a controlling factor. However, despite this gain the consumption is much below normal and the stock much above normal, the indicated world carryover at the end of this year being 13,000,000 bales. The price is within a fraction of a cent of the lowest ever made.

Last year's cotton crop was a weather freak, with the largest yield per acre since the boll weevil came. The acreage is being reduced somewhat, and the use of fertilizer very greatly. The peak of fertilizer use was in 1930; 29 per cent less was used in 1931, and another cut of 50 per cent is being made this year, according to the tag sales to date. A bumper crop takes toll of the soil, and the effects of insufficient fertilization are cumulative. The situation is a difficult one for the grower, who is meeting it as well as possible by raising his living on the farm and depending upon a fortunate season to make his crop. Unless the weather is more favorable than average, however, a substantial reduction in the crop is to be expected.

### Sugar

Cuban raw sugar has been selling recently in New York at 60c for 100 pounds, which is only 40 per cent of the lowest pre-war price. This price is cost and freight less duty, which means that such charges as transportation, ocean freight, insurance, bagging, and export tax, amounting to some 45 cents for the average mill, are included. Selling expense is another item to be deducted. The net price in Cuba is less than the out-of-pocket cash required to harvest the cane and turn it into sugar, disregarding the cost of growing the cane and all other cost factors. The situation is probably without parallel in commodity price history. Of course it cannot last.

Since the war sugar has suffered more than any major commodity from high tariffs, bounties, and quotas; in short, all countries have sought to become more self-sufficient, with resulting profit to none, and the markets where unprotected sugar can be sold have been steadily shrinking. The producers affected have made agreements reducing output and shipments, but the markets open to them have narrowed even more rapidly.

This explains why sugar prices are lower in face of improvement in the world position. The current crop, 1931-32, has been more than 2,500,000 tons smaller than in the previous crop year. Dr. Geerligs, well known Dutch authority, points out in "Facts About Sugar" that for the first time in six years stocks of sugar are lower than on the corresponding date of the preceding year. The preliminary estimate of beet sowings in the most important European exporting countries, Germany, Czechoslovakia and Poland, is for decreases of 22, 14½ and 14 per cent, respectively. The international sugar agreement was modified in March, Cuba agreeing to make only 2,700,000 tons of sugar, while if Java exports in 1932 more than 1,500,000 tons, European exporters will reduce their quotas accordingly.

Cuba is thus making her smallest crop since 1915. Evidently many of the mills now closing down have produced their last sugar for a long time. Certainly many can never grind again unless the world sugar price recovers to a level which would warrant the investment of new capital.

### Rubber

Rubber is like sugar in that the present price of about 3 cents at New York, after deduction of shipping and marketing charges, returns almost nothing to apply to the grower's costs. The price decline has been uninterrupted for four years, but the nature of rubber production makes for great difficulty in going into reverse after unwise expansion. The plantations have been dissipating their cash reserves but have kept on tapping while they had funds, since until recently there was

a smaller loss in producing than in going on a "care and maintenance" basis with nothing coming in.

The situation is a complex one and will require painful readjustments, but clearly has passed the point of tolerance. Reports of plantations and native producers shutting down have become frequent.

Visible stocks of rubber are high, equalling about a year's needs. There has been rapid technical improvement in rubber production, such as the use of budded stock, greatly increasing the yield. The productive capacity of the industry exceeds probable consumption for a long time to come unless important new uses are discovered. Thus there is good reason for rubber being cheaper than formerly, but the present situation seems necessarily a temporary one.

### Other Commodities

Production of the principal non-ferrous metals, copper, lead and zinc, in the United States has declined to the levels of the first decade of this century. Lead stocks were still increasing according to the latest figures, while zinc stocks have changed little since July. Copper statistics are no longer available. Consumption of non-ferrous metals, at present extremely low, is controlled by industrial activity, and general revival of business is needed to bring improvement in their statistical position and higher prices.

The petroleum market is one which has turned upward, due to curtailment of production both by agreement and by low prices. Crude output this Spring and Summer evidently will be much below last year, when the rapid expansion in East Texas occurred. The trend of stocks is downward, the total for all oils at the end of February being 633,000,000 barrels compared with 658,000,000 a year earlier.

The receipts of cocoa in this country since the first of January have been heavier than in any past year, and the New York stock is a very large one. However, the movement is dwindling, and stocks will probably decline at least until the Brazil crops arrive in late summer. It is expected that world consumption this year will exceed production.

Brazilian coffee producers are suffering from over-expansion and excessive stocks much as the rubber producers, and other endeavors to support the price having proved futile, the stopgap of destroying coffee has been adopted. About 4,000,000 bags have already been destroyed and the plan is to burn 8,000,000 more during the current year. This is not calculated to make the producers any better off in the long run, nor to hold the confidence of consumers, but has turned the market up from last year's lows while the price of mild coffees grown outside of Brazil has

dropped sharply. Consumption has increased, and the next Brazilian crop will be a smaller one.

The price of hides is lower than in the '90s, allowing for differences in trimming. The peak of hide and leather stocks was passed at the beginning of 1931. The price situation evidently is one that even slight business revival would soon remedy.

Silk production and consumption have declined from 1931 in nearly the same ratio, and the stocks are not greatly changed. The fall in the value of the yen has been a main influence in the price decline this year. The Japanese government has terminated its effort to stabilize the silk market and sold its stock of 14,144,000 pounds to private merchants, who will distribute the silk within twelve months.

Wool prices recently have been weak. Sheep numbers all over the world have increased and consequently prospects are that the 1932 clip will be about as large as last year. Since the carry-over from the last clip has been somewhat heavier, an ample although not excessive supply of wool is assured.

The foregoing is necessarily brief and presents a mixed picture. But in some cases stability and probably price improvement seems indicated, even upon the present level of consumption. Commodity prices move with business activity and it is hard to say which gives the start, but probably either can give it. It is certain that they will react upon each other with stimulating effect on the way up, as they have depressed each other on the way down.

### **The Money Question**

Every period of depression sees a revival of the money question in some form. At such a time money increases in value in comparison with everything else and is said to be scarce, although there may be as much of it in the country as when trade was active and prices higher. Since money is the medium or standard by which sales and purchases are made, any slowing down of business causes money to circulate more slowly, which gives the impression that there is less of it to be had.

Money, however, is not the only factor in business; the will to spend or invest, or in other words, the psychology of business, is a very important factor. What appear to be fluctuations in the volume of money often are only changes in public attitude toward investing or spending.

In countries with modern banking systems the volume of bank credit in circulation in the form of bank checks is much larger than the total volume of money in use. The amount of credit in use is particularly subject to fluctuations; indeed, what is commented upon as a

scarcity of money usually is a scarcity of credit, or reduction of the available supply due to other conditions than a scarcity of money.

It is a well known fact that the business community has suffered disastrous reactions from time to time from excessive use of credit. One of the results always is abnormal timidity in the use of credit for some time following. The timidity is not only on the part of lenders, but of borrowers as well. The latter, impressed by unsettled conditions and the risk of being in debt, determine to get clear almost without regard to cost, while others who under different conditions might be inclined to use credit for purchases abstain for the same reason. Thus occurs the pressure for liquidation of debts and sale of securities which characterizes such times, giving the appearance of an absence of buying power or lack of means of making purchases. A persistent decline of prices also prompts sales of securities even by owners who are out of debt, but prefer to convert their holdings into cash.

### **Demoralization of Prices**

Such periods of demoralization and uncertainty affect all prices, because they affect confidence and discourage business ventures of every kind. They particularly affect the prices of commodities which must be carried a considerable time in the process of marketing, as in the case of farm products.

The war and all the changes that have characterized the resumption of trade relations since have caused economic disturbances of far-reaching consequences, tending to reduce the volume of trade. The disappearance of Russia as a participant in world trade, and subsequent reappearance in a very disturbing manner, is an illustration. Numerous instances of this kind may be mentioned, but more important than these has been the disruption of price relations between crude products and the products of the more highly organized industries, due to the fact that wages are a more important factor in the latter than in the former. This unbalanced situation has reduced trade and consumption and thus caused unemployment and falling prices in a vicious circle.

Economic authorities are generally agreed that while prices are a monetary phenomenon, influences outside of money frequently are the principal cause of price fluctuations.

### **Proposals for Money Inflation**

Notwithstanding the terrible experiences which the world has had with irredeemable paper money, many of them in the recent past, the great depression, and especially the distressed position of the debtor class, has caused many persons to turn again to the idea of paper money issues as a means of relief. The

belief is that such issues put into circulation would supply buying power where it does not now exist, and that the use of this buying power would start up industry, supply employment, revive general prosperity and raise prices. The objects named of course are desirable; there is no difference of opinion about this.

It is true that a limited volume of paper money is used in all countries as a medium of exchange, in connection with a metallic standard and with provision for conversion into standard money. It is agreed among authorities that use in circulation will sustain the value of a limited quantity at par with standard money, but if the amount exceeds the current needs of business for a circulating medium, it will depreciate, standard money will be expelled and the country will go to a paper basis.

In all proposals for round issues of paper money there is confusion of thought as to the function of money. Money itself is not the source of demand for goods. The purchasing power which gives employment to a nation's workers exists in their labor and in their products and services, which really pay for each other in trade and supply the wants of the workers themselves. Money is useful in accomplishing these exchanges, but a government cannot promote sound business by injecting random issues of paper money into the channels of trade. It introduces a fictitious and incalculable influence which disturbs all the relationships of business life.

There is no scarcity of currency as a means of carrying on business, for currency is automatically supplied from bank deposits. It would be as correct to say that the depression is due to a shortage of railroad cars, although there are thousands of idle cars on storage tracks. If the proposed issue of currency for bonus payments should be made the currency would soon accumulate in the banks and its further use would be as bank credit. The use of credit depends upon confidence throughout the business community. Since currency is the small factor in the total use of credit, if its volume is increased by means which disturb confidence the immediate effect is likely to be a contraction, instead of an increase, in the total volume of credit in use.

#### Dangers of Depreciation

The lessons of experience and the common judgment of students of the subject everywhere have led to the universal policy of entrusting to central banks the responsibility of managing paper money issues and of supplying the final quota of bank credit in any form. This is because institutions of this character, through their relations to the banking system, are in closer touch with the business situation

and in better position to know its needs and serve them with discretion, than any department of the political government.

Whenever a political law-making body has undertaken to supply money to the public in great lump sums the results have been disastrous. Advocates of the pending measure are not disturbed by the warning that it might carry the country off the gold basis. Many of them frankly say that they want a depreciated currency because it will accomplish their purpose of giving higher prices and affording relief to debtors, taking no account of the enormous confusion that would result in industry and trade. They think of the policy as subject to orderly control, but experience has shown that control of currency depreciation is the most dangerous experiment ever attempted by a government.

The most serious thing to be considered is that when a currency starts on a course of depreciation the demand and apparent necessity for more issues never cease as long as the currency has any purchasing value. The depreciation itself makes more of it necessary to handle the same amount of business. Money seemed to be growing scarcer in Germany as the quantity increased. Everybody tried to discount further depreciation, which caused depreciation to be at an increasing rate. It is said, and undoubtedly the statement is at least approximately correct, that after the beginning of the depreciation of the German currency it took two years for the volume to double, but it doubled the second time in two months and the third time in two days. The Germans are a practical people, and skilled in finance, but they were helpless in the toils of currency depreciation, once it was under headway.

The break-down of European currencies was not during the war but afterward, and the story is practically the same for all the countries that had been in the war. France and Italy, by masterful and practically dictatorial leadership, saved their currencies from extinction at the last stage. The currencies of Germany and the Austro-Hungarian empire became totally worthless, and it is worthy of note that in the recent German election every one of the political parties appealing for votes pledged itself to stand at any cost against an increase of the paper money in circulation. There could be no more conclusive testimony from experience than this.

In all of these countries the question of the relation between debtor and creditor became submerged in the more imminent one of how any business could be carried on. Mr. Frank A. Vanderlip in his book entitled "What Happened to Europe," published in 1919, said that the chaos of currencies was enough to make Europe seem like an economic madhouse.

Although the conditions as to low prices and distress of creditors are now quite as bad in Europe as in this country, in none of those countries is there any agitation for government issues of paper money.

#### No Uniformity of Effects

The present situation is due to a disruption of trade relationships. The fact that a given quantity of farm products will buy only one-half as much of manufactures as before the war accounts for millions of unemployed. There is no knowing how this situation would be affected by currency inflation. Confusion would reign. One of the most important questions is what would happen to wages? Would the wage-earners be satisfied to receive present wages as the cost of living increased, or would a series of wage controversies complicate the situation? If wage-earners should be content with present wages, thus restricting price advances in commodities and services already relatively high, a limited rise of other prices would tend to restore former relationships, but once off the gold basis and on a sea of paper money, there is no knowing what the changes in the purchasing power of wages would be. If the purpose is to restore former price relationships it would be accomplished with more certain protection to the wage-earners, if they would accept wage-reductions in terms of the present money.

#### The Relation of Debtor and Creditor

The objectives of higher prices and relief for debtors would seem to be assured by the simple fact of currency depreciation, but, if this involved the loss of a definite standard of value, and a repetition of the experience of other countries with irredeemable paper currency, the gains of the debtor class would be as illusory as the gains of the creditor class would be if present conditions should remain unrelieved. It should be understood that nobody wants a continuance of present conditions or can gain by it. The matter of supreme importance is to get industry and trade back on a normal basis, with employment to provide a livelihood for our millions of people. This is not only the primary need but it will revive normal consumption and prices and thus restore former debtor-creditor relations. Disorder in industry and trade is not likely to be remedied by issues of irredeemable currency. They are the most fruitful source of disorder known to organized society. Their avowed purpose is to alter all contract relations now existing in terms of money, but the effect would be to deprive business of any stable basis for contract relations in the future. This would mean more and worse confusion. If the country found itself with an

irredeemable currency its first problem would be to stabilize it and establish confidence in it.

The effects of currency depreciation upon the credit situation are not altogether to the advantage of debtors. It might be easier in some cases to pay existing debts, but if renewals were desired or new loans were sought the situation would be clouded. The risk of payment in a depreciated currency is never overlooked. In Germany after depreciation was well under way interest rates as high as 100 per cent per annum were demanded and later there were no lenders at any interest rate. Business becomes impossible under such conditions.

In short, the complications resulting from an effort to relieve debtors by currency depreciation are endless and all tend to demoralization, rather than to the restoration of orderly industry. If one Congress assumes to work its will with the currency so may the next and the next and so on. There is need for the greatest possible stability in the monetary factor, which is the basis of all business relations and calculations, of order and confidence. That stability cannot be had in money poured out by acts of Congress.

In this case, President Hoover has announced his opposition to the bill, and there is understood to be no danger that it can become a law over his veto, but the agitation for it is an obstruction to the revival of business.

#### Currency Issues Should Be by the Reserve Banks

The argument against issues of currency directly by acts of Congress for specific expenditures does not apply to credit expansion through the regular agencies established for regulating the currency. The Federal Reserve Banks have the resources and authority for supplying any amount of credit that business may require, and can do so in an orderly manner, which will not of itself occasion alarm. The world has a terror of uncontrolled currency inflation. A discussion of present Reserve policy appears elsewhere in this issue and need not be repeated here.

It possibly may be said of this policy as has been said of other measures recently put into effect, that it gives aid to banks, railroads and other important corporations rather than to the mass of the people, but that criticism overlooks the fact that support is most effective for the whole situation if given to organized business. The most essential thing is to maintain and increase employment. The industrial organization must be maintained in order to afford employment and perform necessary services. To a great extent the industries are necessary to each other and support each other. The Government could not support the people if the industrial system and the agencies which serve it were broken down.

### Gold Supplies and Movements

The first table following shows the increase of gold stocks in central banks and government treasuries according to available records for fourteen principal countries (excepting Russia) from 1900 to 1913 and for forty-four countries from 1913 to 1932. Except for 1932 they are as of the end of each year. This shows that for the fourteen countries to 1913 the increase was only about \$100,000,000 per year, although gold production averaged about \$400,000,000, gold in that period entering largely into circulation. The figures for the forty-four countries show the concentration in banks and treasuries after the war, not only of new production but of gold coin previously in circulation. It will be seen that the gold reserves rose from \$4,061,000,000 at the end of 1913 to \$10,914,000,000 at the end of 1931, or by \$6,853,000,000, practically 170 per cent, which throws light upon both the inflation and deflation of credit which occurred during that period. The rate of increase in gold reserves was far above the increase in physical volume of business, and together with the influence of the war caused the great rise of the wage and price level to 1929. It will be seen that the rise of gold reserves has occurred mainly since the end of the war. The great rise of prices of course fostered speculation and an increase of indebtedness, as it always does, and this was especially so in the United States, because the war and disorder in Europe after the war caused a greater concentration of gold here than in any other country.

Although the increase of gold reserves was at a slower rate after 1927, in the aggregate it would have been enough to care for the normal increase of industry and trade, but for the tendency to concentration in a few countries, as shown by the second table, and particularly the figures for the United States and France. This concentration was itself the result of disorder in the trade and financial relations between nations, in various ways due to the war, and finally to the disturbance of credit which caused a concentration in the creditor nations:

Gold Stocks of Central Banks and Governments (Outside of Russia, as reported by the Federal Reserve Bulletin)			
(In millions of dollars)			
14 countries			Increase
1900 .....	1,665		
1913 .....	2,958		1,293
44 countries			
1913 .....	4,061		
1918 .....	6,801		2,740
1927 .....	9,462		2,661
1928 .....	9,927		465
1929 .....	10,150		223
1930 .....	10,658		508
1931 .....	10,914		256
1932 First Quarter.....	11,100*		

\* Preliminary.

In the following table twenty-five countries are classed in a general way as "creditor" and "debtor," but the Scandinavian states are not strictly in the latter class, although since the war they have borrowed abroad to some extent.

Gold Holdings (end of each year or last report date)  
(In millions of dollars)

Creditor Countries	1900	1913	1928	1931	1932
United States* .....	511	1,290	3,746	4,051	3,977
Great Britain .....	139	165	748	588	591
France .....	451	679	1,253	2,699	3,018
Belgium .....	21	48	126	354	349
Switzerland .....	19	33	103	453	471
Netherlands .....	24	61	175	357	356
	1,165	2,276	6,151	8,502	8,762
Debtor Countries					
Germany .....	119	279	650	234	205
Italy .....	78	265	266	296	296
6 Danubian States.....	200	302	170	194	191
4 Scandinavian States ..	22	69	152	143	134
Poland .....	....	....	70	67	63
Spain .....	67	82	494	434	434
Japan .....	32	65	541	234	215
Australia .....	....	22	109	62	52
Canada .....	....	117	114	78	75
Argentina .....	....	256	607	253	244
Brazil .....	....	90	149	....	....
		1,557	3,322	1,985	1,914
25 above countries.....		3,833	9,483	10,487	10,676

\*Excluding gold in circulation.

The six creditor countries now hold 80 per cent of all gold monetary stocks, which, except in the case of Great Britain, is far more than normal requirements for the amount of credit they are employing, while business in the debtor countries is being strangled for lack of a sufficient supply.

### Holdings of United States and France

By the middle of April, 1932, about 63 per cent of the gold reserves of the world outside of Russia were in two countries, the United States and France. The reserves of these countries and aggregate world reserves are shown below, also the increase in the two countries since the end of 1928, and increase in the world including the two countries:

(In millions of dollars)		
	Middle of April 1932	Increase since Dec. 1928
United States .....	3,977	231
France .....	3,018	1,765
	6,995	1,996
World .....	11,100	1,178

The two countries in the period named had absorbed not only all of the world's new production since 1928, but also some \$750,000,000 of gold that had come either from the reserve of other countries or was released from hoards in India and China.

### Exchange Relations

Even the above does not fully describe the state of chaos which has developed in international monetary relations. Since the end of 1928 foreign exchange holdings of the

twenty-five countries included in the previous table have been reduced from about \$2,400,000,000 to about \$850,000,000. Moreover, of the latter sum nearly \$500,000,000 belongs to the Bank of France and is in process of repatriation.

In the period following the war, when the central banks of numerous countries were getting back upon the gold basis, many of them adopted the policy of keeping a part of their reserves employed in the central money markets, particularly London and New York, on call or short notice. Such investments were readily convertible, and the funds when wanted were likely to be wanted for payments in the central markets. This policy was known as the gold exchange system, and was approved by economists as effecting an economy in the use of gold. Reduction of these foreign exchange holdings began with the fall in the prices of the principal exports of debtor countries, which created adverse balances in their exchanges and compelled drafts on foreign balances; but the departure of the Bank of England from the gold basis also had an important influence upon the practice of maintaining foreign balances and operations in foreign money markets.

The low state of these foreign balances evidently means that the facilities for international trade are very much curtailed. The debtor countries have been compelled to drastically curtail their imports from the creditor countries, and will not be able to resume their imports in the former volume until they have regained their purchasing power through a rise in the prices of their exports.

#### Off the Gold Basis

Since the departure of Great Britain from the gold basis, Norway, Sweden, Denmark, Finland, India, Egypt, Portugal and the Straits Settlements, on account of trade relations with Great Britain, have sought to stabilize their currencies to the pound sterling rather than to gold. Japan and Greece have an embargo on gold exports, and the currency is depreciated. In numerous other countries exchange restrictions are in force or gold exports are regulated, so that the gold standard remains in full effect in only six countries, viz.: the United States, France, Netherlands, Belgium, Switzerland,

and the Union of South Africa. The exchanges therefore are greatly confused, trade is seriously hampered and heavy losses have been suffered in international transactions. Moreover, countries continue to restrict commodity imports in various ways for the double purpose of protecting their exchange positions and home industries. The effect is to intensify the world depression.

If the countries which are now off the gold basis should remain off and give up their gold reserves to the other countries the normal effect should be to ease the credit situation in the latter and promote a rise of prices until a general readjustment was made. However the credit strain everywhere in the last year has been because of a loss of confidence rather than heavy demands of business. Moreover, permanent ease or stability is an ideal rather than an actual state, for the business world tends to work up to the limit of credit expansion, whatever the monetary or credit system may be. Theories are advanced for a "managed" currency, the principle being that of control of the volume of credit with a view to maintaining a stable level of prices, but the difficulties are formidable. Great Britain is experimenting with this policy temporarily, and in London there is talk that Britain may become the center of a group of nations that will keep their currencies in close relations to the pound sterling, as they have been accustomed to do under the gold standard, but the present Chancellor of the Exchequer has expressed the opinion that the country will return to gold when conditions have become settled.

It is apparent that monetary affairs the world over are almost in a state of chaos, and the state of business corresponds. It is impossible to say either that the state of money or the state of business is responsible, for either reacts upon the other. The war is primarily responsible, by having thrown the highly organized modern system of industry and finance into confusion. These results have cost more both in human suffering and wealth than the war itself. There is today greater need of mutual understanding and a spirit of cooperation between the nations and between all classes and groups of people within every country than ever before. Organized industry has been the basis of social progress.

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